Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Infosys

Racing ahead on the digital highway

IT & ITES	Sharekhan code: INFY	Company Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,512**	
Price Target: **Rs. 1,700**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

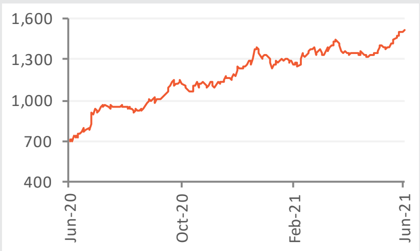
Company details

Market cap:	Rs. 644,176 cr
52-week high/low:	Rs. 1,520 / 692
NSE volume: (No of shares)	78.2 lakh
BSE code:	500209
NSE code:	INFY
Free float: (No of shares)	370.9 cr

Shareholding (%)

Promoters	13.0
FII	50.5
DII	24.0
Others	12.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	12.1	10.2	28.5	114.8
Relative to Sensex	8.3	5.2	13.1	64.2

Sharekhan Research, Bloomberg

Summary

- We retain a Buy rating on Infosys with a price target of Rs. 1,700, given strong revenue growth and deal momentum and faster recovery in developed markets.
- Infosys' strategic investments on digital capabilities have helped it gain market share over last three years and boosted its ability to participate in mega transformation deals.
- Management indicated that revenue would not be materially impacted Q1FY2022 because of the second COVID-19 wave. Transition costs of a large deal could however hit margins in Q1FY2022, partially offset by revenue growth and higher offshoring.
- FCF increased 44% y-o-y to Rs. 22,020 crore in FY2021, implying an FCF/EBITDA ratio of 79%. Further, Infosys returned 83% of its two-year FCF to shareholders through dividends and buybacks, in line with its current capital allocation policy.

We recently interacted with Infosys' management to understand the demand, pricing, deal pipeline, talent supply and margin outlook. The management highlighted that its prior strategic investments on digital capabilities have helped it gain market share in the last three years and have bettered its ability to participate in mega transformation deals. After the breakout of COVID-19, the pace of Cloud adoption has accelerated across industries as it would bring operational agility, enable remote working and evolve new digital models for the enterprises. We believe that Infosys is well-positioned to be a major participant in clients' cloud transformation journey given its investments on Cloud technologies and its partnerships with hyper-scalers and SaaS providers. Further, the management highlighted that its deep digital capabilities have helped the company to bring together its best practices to deliver best solutions to clients, which resulted in 57% y-o-y growth in large deal win TCVs in FY2021. In addition, its prior investments on localisation and re-skilling of talents provide better prospects to win transformation deals versus earlier. The management indicated that there is no material impact on its revenue because of the second COVID-19 wave. Strong digital capabilities, investments in localization and re-skilling of talents should drive market leading growth for Infosys in the medium-term. Further, the management indicated that its deal pipeline stays robust despite the record high TCVs in clocked FY2021. Hence, Infosys remains confident of delivering another year of market-leading performance in FY2022. The management indicated that the costs related to the transition of the Daimler deal are likely to impact margin in Q1FY2022, which would be partially offset by revenue growth, higher offshoring and change in business mix. The management highlighted that its EBIT margin guidance of 22-24% for FY2022 has factored in the next round of wage revision effective from Q2FY2022, return of travel and discretionary expenses from H2FY2022 and dilution from the transition of the large deal. Infosys' free-cash flows (FCF) increased 44% y-o-y to Rs. 22,020 crore in FY2021, implying FCF/EBITDA of 79%. Infosys returned 83% of its two-year FCF (FY2020 and FY2021) to shareholders through dividends and buybacks, which is broadly in-line with its capital allocation policy announced in July 2019.

Our Call

Valuation – Maintain Buy with a PT of Rs. 1,700: Strategic investments toward digital capabilities, reskilling of talents and localization placed Infosys well to participate in its client's digital and cloud transformation journey and add large accounts. Given its strong execution, enhanced digital capabilities and a robust global delivery model, the company is well placed to remain at the forefront for capturing the opportunities in the areas of core modernisation, digital transformation and developing new cloud native applications. We expect Infosys to clock USD revenue and earnings growth of 15% and 17%, respectively, over FY2021-FY2023E. At CMP, the stock is trading at 28x/24x its FY2022E/FY2023E EPS. We continue to prefer Infosys as it is one of the industry leaders with robust execution capabilities, strong balance sheet, healthy FCF generation capability, and higher dividend payout. Given strong growth and deal momentum, we maintain our Buy rating on the stock with a revised PT of Rs. 1,700.

Key risk

Rupee appreciation and/or adverse cross-currency movements and slackening pace in deal closures would have an adverse impact on its earnings.

Valuation Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	1,00,473.0	1,19,289.5	1,35,536.9	1,49,004.5
OPM (%)	27.8	26.8	26.7	26.8
Adjusted PAT	19,423.0	22,896.4	26,374.2	29,581.2
% YoY growth	*17.0*	*17.9*	*15.2*	*12.2*
Adjusted EPS (Rs.)	45.6	54.0	62.1	69.7
P/E (x)	33.1	28.0	24.3	21.7
P/B (x)	4.5	4.2	3.9	3.6
EV/EBITDA (x)	22.4	19.5	17.1	15.4
RoNW (%)	27.2	28.9	31.2	32.0
RoCE (%)	34.4	36.5	39.5	40.8

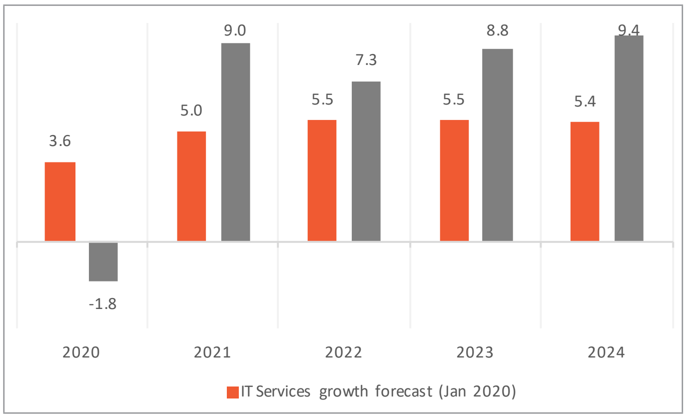
Source: Company; Sharekhan estimates

Accelerated digital and cloud adoption among large enterprise to drive growth

Software and computing technologies are transforming businesses across the industries around the world. Companies are rapidly adopting digital technologies to reimagine cost structures, increase business resilience and agility, personalise experiences for customers and employees. While the adoption of new-age technologies had been progressing at a steady rate for a few years now, these trends have been accelerated with the need for business continuity, operational resilience and the switch to digital transactions because of the COVID-19 pandemic.

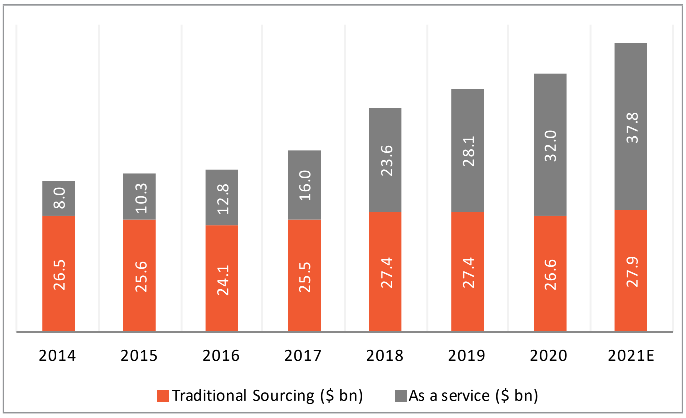
According to the latest forecast, Gartner expects worldwide IT spending of $4.1 trillion in 2021, an increase of 8.4% y-o-y. However, Gartner estimated that IT services spends would grow by9% in FY2021 after a decline of 1.8% y-o-y in FY2020. IT services spending is likely to clock an 8.6% CAGR over FY2021-FY2025, led by strong 16.5% CAGR in overall digital technology. Digital technologies such as cloud hosting, cloud migration, ADM DevOps, consulting, IoT, etc would report a 15-20% CAGR in incremental revenue over FY2021-FY2025, while next-generation technologies (5G, robotics, and Blockchain) are expected to report a CAGR of 35-45% over the same period.

Industry experts revised in IT services spending



Source: Gartner, Sharekhan Research

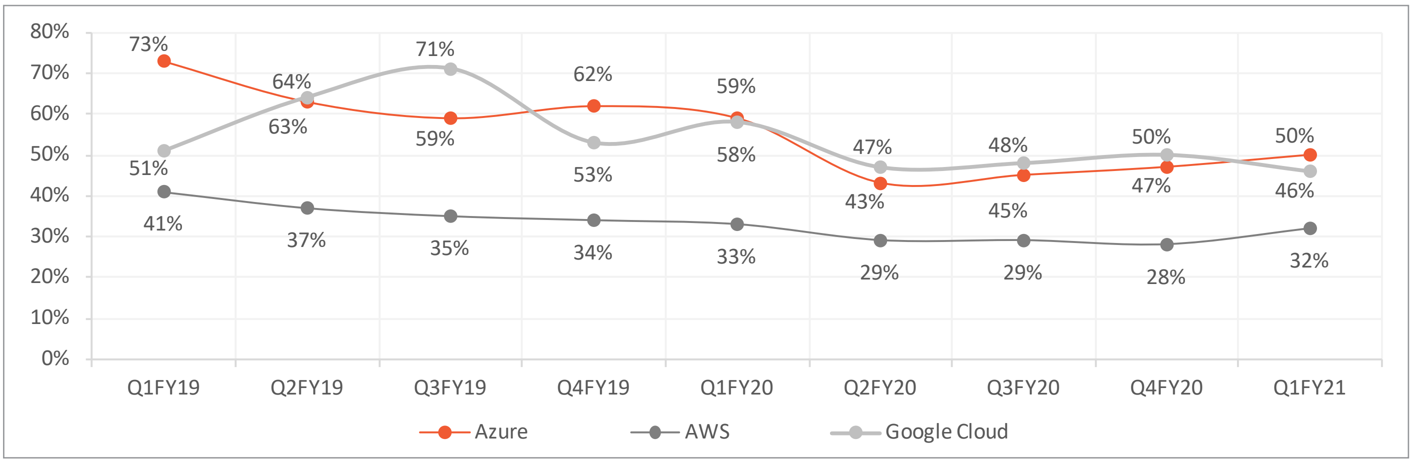
Strong recovery in global ACV in CY20



Source: ISG, Sharekhan Research

There is a strong demand in areas such as cloud led end-to-end digital transformation, customer experience, data analytics and 5G led network modernisation. The strong growth in revenue of Cloud providers offers confidence for strong growth of Indian IT. Cloud continues to be one of the major themes for the IT services industry from a near-to-medium term perspective. The cloud computing market is expected to grow at a CAGR of 17.5% from $371.4 billion in 2020 to $832.1 billion in 2025. The higher spend on Cloud would have an upside risk from data, analytics and AI spends.

COVID has accelerated the need for faster Cloud adoption



Source: Company; Sharekhan Research

Cloud expertise and partnerships with hyperscalers would provide multi-year growth

The pandemic has forced enterprises across the industries to embrace cloud to improve time to value, increase agility and reduce costs. It is believed that Cloud is core to long-term growth opportunities for enterprises as it would bring operational agility, enable remote working and evolve new digital models. The future of enterprise cloud strategy will depend on business agility, scaled innovation and security of the ecosystem. However, enterprises find it difficult to evaluate the return of their investments on cloud technologies due to legacy burden and complexity of cloud. Infosys enables businesses to redesign the enterprise from the core, and also build new cloud-first capabilities to create seamless experiences in public, private and hybrid cloud, across PaaS, SaaS, and IaaS landscapes.

In FY2021, Infosys launched its integrated cloud offering, Infosys Cobalt, bringing together 14,000+ cloud assets, 200+ solution blueprints and an array of ecosystem alliances. Infosys Cobalt is helping enterprises to securely access cloud capabilities with the assurance of single-point accountability for outcomes. Infosys also launched Infosys Applied AI to help enterprises adopt a comprehensive approach and roadmap to scaling enterprise-grade AI for their businesses. Given its scale and end-to-end capabilities, the company would participate in both 1) core modernisation and 2) developing new cloud native applications. Though revenue from Cloud is growing at faster rate for hyperscalers, management indicated about strong demand for private cloud among enterprises. Hence, management believes that the increasing demand for cloud transformation would create huge opportunities for Infosys as enterprises would reinvent themselves through digital and cloud in coming years. We believe that Infosys is well-positioned to play as a prime orchestrator of the cloud journey for enterprises given its investments on cloud technologies and its partnerships with hyper-scalers and SaaS providers.

Strategic investments toward digital capabilities provide better revenue growth visibility

Among the strategic agendas that were laid out in 2018, Infosys has progressed well on its strategic priorities, including scale agile digital and gained market share over last three years. The company's investments in areas such as 1) Cloud, 2) data, 3) experience and 4) cyber security have been reaping benefits, which were reflected from strong performance in its digital business during COVID-19. The company's digital revenue has reported a 7.4% CQGR since Q1FY2018 and its contribution stood at 51.5% in Q4FY2021. Further, management highlighted that its deep digital capabilities have helped the company to bring together its best practices across the company to deliver best solutions to its clients. Its enhanced digital capabilities helped the company in terms of wining large deals from Vanguard and Daimler in FY2021. Infosys has acquired four companies such as GuideVision, Kaleidoscope Innovation, Blue Acorn and Carter Digital in the areas of design and cloud in FY2021.

Infosys has made significant investments in expanding its local workforce in the US, the UK, Europe, Japan, China and Australia. In FY2021, the company recruited over 7,280 employees locally in its markets, of which 1,941 were fresh graduates. The company's localisation in the US is moving towards 70% on the back of employee rebadging from Vanguard deal and a few acquisitions in the US. The management indicated that its earlier investments in reskilling of talents and localization helped it to deliver projects seamlessly during the time of travel restrictions. As Infosys is rated by industry experts in the top quadrant across key digital competencies, we believe the company has better prospects to continue to win transformation deals versus earlier.

Set to outrun industry again in FY2022; deal pipeline remains strong

The management reiterated its earlier commentary on the outlook as it has not witnessed any incremental changes in demand so far during the quarter. Further, it indicated that there is no material impact on its revenue because of the second COVID-19 wave. Infosys indicated growth in FY2022E would be driven by faster adoption of digital and cloud technologies, legacy modernisation, strong deal wins ($14.1 billion in FY2021 versus $9 billion in FY2020), better pricing for digital business, and stronger deal pipeline. This coupled with its strong digital capabilities, investments in localisation and relatively well positioned from a talent perspective should drive market leading growth for Infosys in the medium term. Further, management indicated that the deal pipeline continues to be robust despite the record high TCV in FY2021. Hence, management remains confident on delivering another year of market leading performance in FY2022.

Expect a sustainable margin performance in subsequent quarter

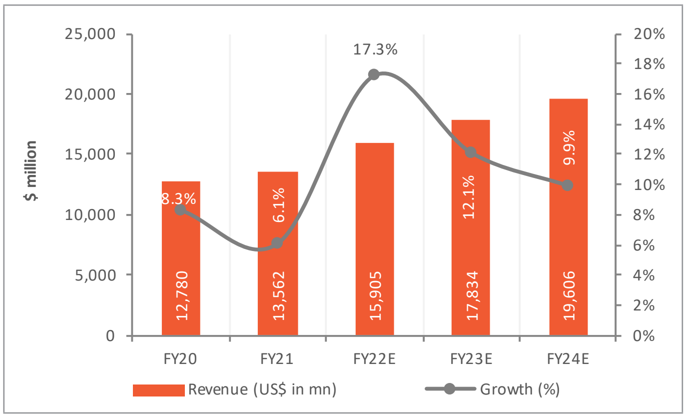
The management highlighted that margin guidance for FY2022 has factored in the next round of wage revision effective from Q2FY2022, return of travel and discretionary expenses from H2FY2022 and dilution from the transition of the large deal. Management indicated that it has higher pricing for valued-added digital offerings would offset the pricing pressure in the legacy business. The digital business contributed 51.5% of its total revenues in Q4FY2021. Management indicated that the costs related to the transition of the Daimler deal are likely to impact margin in Q1FY2022, which would be partially offset by the revenue growth, higher offshoring and change in business mix. We believe that scaling up of digital services, higher automation, higher offshore revenue, and onsite pyramid rationalisation would help Infosys keep OPM above pre-COVID levels in the coming years.

Cash flow conversion remained strong; efficient capital allocation policy

The company's CFO/EBITDA ratio improved to 87% in FY2021 from 83% in FY2020, led by release of the working capital. Infosys' free-cash-flow (FCF) increased 44% y-o-y to Rs. 22,020 crore in FY2021, implying FCF/EBITDA of 79%. Infosys returned 83% of its two-year FCF (FY2020 and FY2021) to shareholders through dividends and buybacks. Infosys has provided highest payout to shareholders in the form of dividends and buybacks among its large peer groups in the past three years.

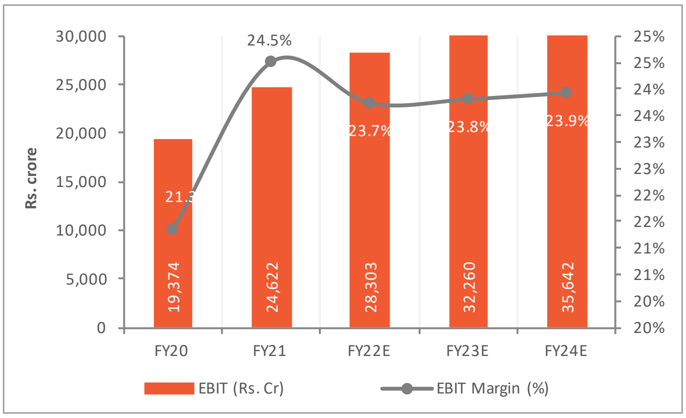
Financials in charts

Revenue in US$ (mn) and growth (%)



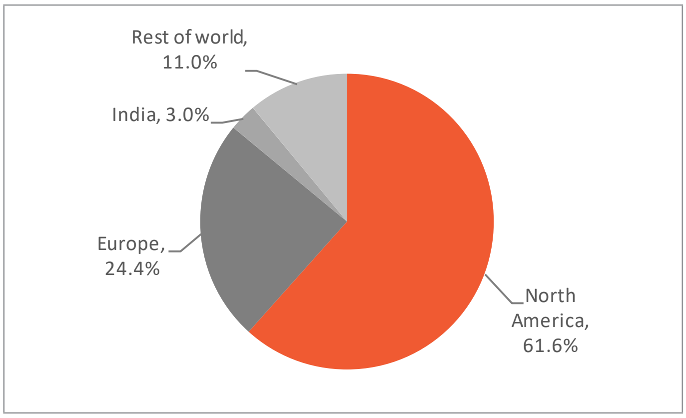
Source: Company, Sharekhan Research

EBIT (Rs. cr) and EBIT margin (%)



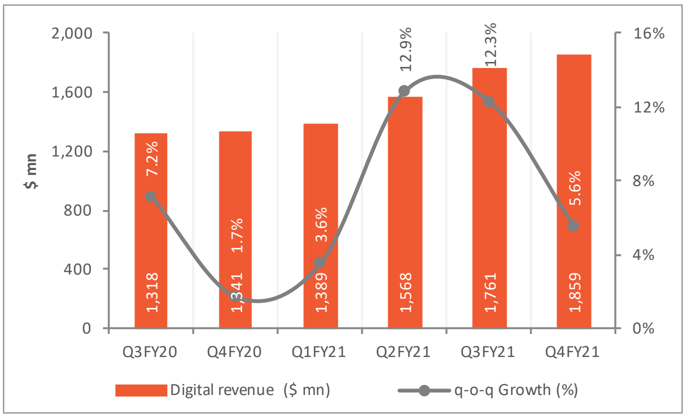
Source: Company, Sharekhan Research

Geography break-up (%)



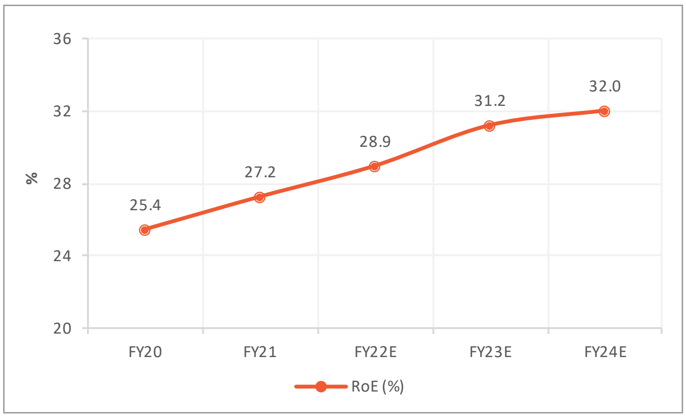
Source: Company, Sharekhan Research

Digital revenue ($ mn) and growth (%)



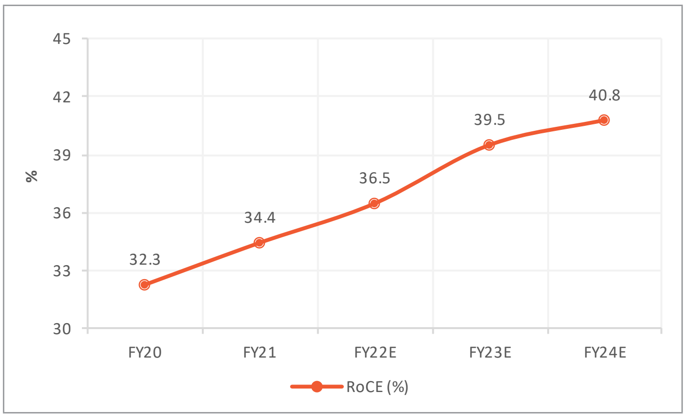
Source: Company, Sharekhan Research

RoE trend (%)



Source: Company, Sharekhan Research

RoCE trend (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Technology spending to accelerate going forward

The COVID-19 pandemic is estimated to drag the world output by 3.3% in CY2020, with 4.7% contraction in the advanced economies. As a result, global technology spend is estimated to decline 3.2% to $1.4 trillion in 2020. Within that, IT services spending declined 3.9%, while business process management spends fell by 2.4%. After the initial dislocations led to contractions, the need for business continuity, operational resilience and the switch to digital transactions has led to strong demand for IT services. Industry analysts such as Gartner estimate that IT services spending would grow by 7-9% over CY2021-CY2024E as compared to the average of 3.6% achieved in CY2010-CY2020. Forecasts indicate higher demand for cloud infrastructure services, a potential increase in specialised software, potential investments in transformation projects by clients, and increased online adoption across verticals.

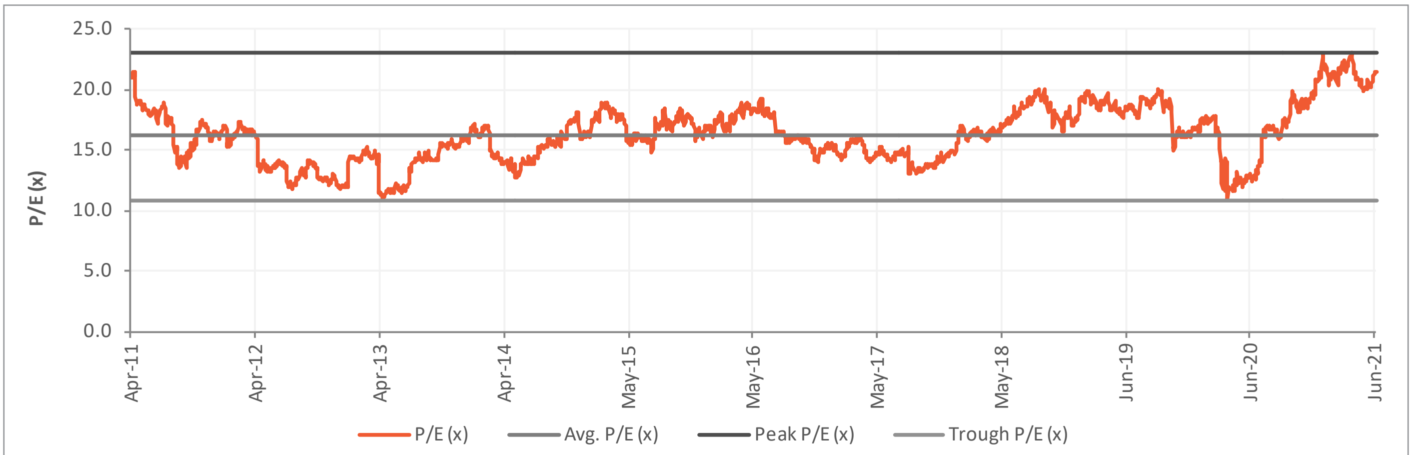
■ Company Outlook – Well positioned to capture opportunities

Infosys services a large number of Fortune 500/Global 500 clients and these have a strong balance sheet and are able to hold on better in the economic downturn. Further, Infosys has aggressively invested in digital technologies in the past couple of years to capture the large portion of upcoming digital spends. Given strong relationships with clients and robust execution capabilities, Infosys is well-positioned to capitalise on opportunities from the transformation journey of clients.

■ Valuation – Maintain Buy

Strategic investments toward digital capabilities, reskilling of talents and localization placed Infosys well to participate in its client's digital and cloud transformation journey and add large accounts. Given its strong execution, enhanced digital capabilities and a robust global delivery model, the company is well placed to remain at the forefront for capturing the opportunities in the areas of core modernisation, digital transformation and developing new cloud native applications. We expect Infosys to clock USD revenue and earnings growth of 15% and 17%, respectively, over FY2021-FY2023E. At CMP, the stock is trading at 28x/24x its FY2022E/FY2023E EPS. We continue to prefer Infosys as it is one of the industry leaders with robust execution capabilities, strong balance sheet, healthy FCF generation capability, and higher dividend payout. Given strong growth and deal momentum, we maintain our Buy rating on the stock with a revised PT of Rs. 1,700.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBIDTA (x)		P/BV (x)		RoE (%)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
HCL Tech	981	271	2,66,333	19.6	17.4	12.0	10.7	4.0	3.6	21.4	21.8
TCS	3,301	370	12,20,927	30.3	26.9	21.7	19.6	12.6	11.1	43.3	43.7
Wipro	556	548	3,04,891	26.8	23.5	16.9	15.3	5.4	4.8	19.0	19.7
Infosys	1,512	426	6,44,176	33.1	28.0	22.4	19.5	4.5	4.2	27.2	28.9

Source: Company, Sharekhan estimates

About company

Founded in 1981, Infosys is the second largest ($13,562 million in FY2021) IT services company in India in terms of export revenue with headcount of 2.6 lakh employees. BFSI accounts for the largest chunk of revenue (~33% of total revenue), followed by retail, energy and utilities, and communication. Region wise, North America and Europe continue to be the mainstay. Digital revenue continued to have a strong growth momentum in the past few quarters and now contributes 51.5% to total revenue.

Investment theme

Infosys has accelerated deal wins momentum through engagement with deal advisors, consulting firms, and private equity players. Effectively, the strong large deal trajectory provides better revenue growth visibility. Further, revitalisation of sales and investment in digital competencies have certainly helped the company to drive its digital business. Sharp focus on execution and augmentation of digital capabilities through investments can bring Infosys back on its high-growth trajectory. Given strong deal wins, strengthening relationships with large clients, and continued digital momentum, we believe Infosys is well positioned to catch up with leaders on revenue growth in the coming years.

Key Risks

1) Regulatory visa norms could have an impact on employee expenses; 2) any instability in leadership; additional exits at senior management level; 3) Rupee appreciation and/or adverse cross-currency movements; and 4) increasing attrition rate.

Additional Data

Key management personnel

Nandan M. Nilekani	Co-founder and Non-Executive Chairman
Salil Parekh	Chief Executive Officer
U.B. Pravin Rao	Chief Operating Officer (COO)
Nilanjan Roy	Chief Financial Officer
Ravi Kumar S	President, Deputy COO
Mohit Joshi	President, Head – BFSI and HCLS

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Deutsche Bank Trust Co Americas	17.19
2	Life Insurance Corp of India	5.86
3	BlackRock Inc	4.55
4	SBI Funds Management Pvt Ltd	2.67
5	Vanguard Group Inc/The	1.80
6	ICICI Prudential Asset Management	1.52
7	Republic of Singapore	1.47
8	HDFC Asset Management Co Ltd	1.23
9	ICICI Prudential Life Insurance Co	1.23
10	UTI Asset Management Co Limited	1.21

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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